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CALIFORNIA BUSINESS NET RECEIPTS TAX (BNRT)

What follows is a tentative outline for a proposed business net receipts tax (BNRT) for the State of California, which is a part of the tax packages to be discussed at the Commission's hearing on July 16, 2009. The BNRT being considered would be imposed on all business entities in the state. The structure as described is tentative only. The discussion is not meant to imply that structure for this tax has been determined and the tax treatment of various components has been finalized

- The BNRT is a tax imposed on the privilege of doing business and measured, not by income or property, but by the value added by a business entity.
- The BNRT is imposed on all forms of doing business, including sole proprietorships, pass-through entities (e.g. general partnerships, limited partnerships, S corps., and entities that check the box to be treated as partnerships for tax purposes), and corporations (C corps. and business entities that check the box to be treated as corporations for tax purposes).
- Exempt organizations will pay the BNRT only on net receipts from business activities unrelated to the exempt activities.
- The BNRT will not apply to insurance companies, which would remain subject to the gross premiums tax.
- Bank and financial companies will not be subject to the BNRT, which would remain subject to the bank and corporation tax.
- Entities such as Regulated Investment Companies (RICs), Regulated Mortgage Investment Conduits (REMICs), and Financial Asset Securitization Investment Trusts (FASITs) will not be subject to the BNRT.
- Real Estate Investment Trusts (REITs) will be subject to the BNRT
- Extractive businesses will be subject to the BNRT.
- "Doing business" means actively engaging in any transaction for the purpose of pecuniary gain. A taxpayer is doing business in this state for a taxable year if any of the following conditions has been satisfied:¹
 - The taxpayer is organized or commercially domiciled in this state;
 - Sales of the taxpayer in this state exceed the lesser of \$500,000 or 25 percent of the taxpayer's total sales;
 - The real property and tangible personal property of the taxpayer in this state exceed the lesser of \$50,000 or 25 percent of the taxpayer's total real property and tangible personal property; or
 - The amount paid in this state by the taxpayer for compensation exceeds the lesser of \$50,000 or 25 percent of the total compensation paid by the taxpayer.
- The BNRT equals the business net receipts tax base after apportionment, multiplied by the tax rate.
- The business net receipts tax base is gross receipts less purchases from other businesses.
- "Gross receipts" for purposes of calculating the business net receipts tax base will be the same as for purposes of calculating the sales factor.
- "Gross receipts" will mean the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, and royalties) in the trade or business of the taxpayer.²
- "Gross receipts" will exclude the following:³

¹ This definition of "doing business" is currently effective for taxable years beginning on or after January 1, 2011.

² Current definition of gross receipts for sales factor purposes, in effect for taxable years beginning on or after January 1, 2011.

- Repayment, maturity, or redemption of the principal of a loan, bond, mutual fund, certificate of deposit, or similar marketable instrument.
- The amount of principal received under a repurchase agreement or other transaction properly characterized as a loan.
- Proceeds from issuance of the taxpayer's own stock or from sale of treasury stock.
- Damages and other amounts received as the result of litigation.
- Property acquired by an agent on behalf of another.
- Tax refunds and other tax benefit recoveries.
- Pension reversions.
- Contributions to capital (except for sales of securities by securities dealers).
- Income from discharge of indebtedness.
- The price of commodities or other goods that are traded for similar commodities or other goods, whether such trading is done for hedging or other purposes.
- The value of assets transferred in a like-kind exchange.
- Amounts received from the maturity, redemption, sale, exchange, or other disposition of intangible assets held in connection with a treasury function of the taxpayer.
- Amounts received from trading in stocks, bonds, derivative financial instruments including futures, forwards, and options.
- Amounts received from selling accounts receivables if the sales that generated those accounts receivables are included in the taxpayer's gross receipts.
- Amounts received from selling land and other assets that are not subject to depreciation, amortization or depletion except to the extent of the gain on the sale of these assets.
- Amounts received from selling all or part of a business except to the extent of the gain on the sale.
- Interest income received
- "Purchases from other businesses" will include only the following:
 - Rents.
 - Royalties.
 - Inventory acquired during the year for resale.
 - Assets acquired during the year.
 - Materials and supplies acquired during the year.
 - Services acquired during the year.
- "Assets acquired during the year" is limited to amortizable assets, depletable assets and depreciable assets, and the amount that can be expensed each year will be calculated in the following manner:
 - For amortizable assets, the purchase price will be expensed over 7 ½ years. In the first year, 1/15 of the purchase price will be expensed. For each remaining year, 2/15 of the purchase price will be expensed.
 - Depletable assets will be expensed on a cost depletion basis, over ½ the federal useful life (as defined in the IRC as of January 1, 2005).
 - Depreciable assets will be expensed over ½ of the federal MACRS depreciable life (as defined in the IRC as of January 1, 2005). For example, if an asset would have a 3-year MACRS life under the IRC, the asset would be expensed in 1 ½ years under the BNRT, 1/3 of the purchase price in year one, and 2/3 in year two.
- "Services acquired during the year" excludes a business' own payroll expenses.
- "Services acquired during the year" includes payments to subcontractors.
- "Purchases from other businesses" includes purchases made with borrowed funds.
- If the taxpayer's purchases from other businesses are equal to or greater than the taxpayer's gross receipts, the taxpayer's net receipts tax base would be zero.

³ A similar list of exclusions from gross receipts, for sales factor purposes, is currently in effect for taxable years beginning on or after January 1, 2011.

- If the taxpayer's purchases from other businesses in one year are greater than the taxpayer's gross receipts for that year, the taxpayer will be allowed to carry over those excess purchases to the next five years to reduce the net receipts tax base in those subsequent years.
- The business net receipts tax base of a unitary business group would be the sum of business net receipts of each entity that is included in the unitary business group.
- The unitary business group will consist of the water's edge group.
- Transactions within the unitary business group (i.e. the water's edge group) will be eliminated.
- The business net receipts tax base is apportioned to this state using a formula consisting of a single sales factor.
- The single sales factor will have a numerator consisting of gross receipts in California and a denominator consisting of gross receipts everywhere.
- So long as a member of the unitary business group has nexus in this state, the sales in this state by any other member of the unitary business group will be included in the numerator of the single sales factor. (*Finnigan rule*.)⁴
- To determine the sales factor numerator, sales of tangible goods would be sourced to California according to current California R&TC § 25135. Sales of services and intangibles would be sourced according to revised California R&TC § 25136.⁵
- The BNRT on a sole proprietorship will be deductible against the sole proprietorship's income for purposes of calculating the sole proprietor's personal income tax liability.
- The BNRT on a pass-through entity will be deductible against the pass-through entity's income for purposes of calculating a partner's individual income tax liability if the partner is an individual.

⁴ Currently in effect for taxable years beginning on or after January 1, 2011.

⁵ Currently in effect for taxable years beginning on or after January 1, 2011.